

No. 11,795

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

ESTATE OF ISADORE ZELLERBACH, DECEASED, J. DAVID
ZELLERBACH AND HAROLD L. ZELLERBACH, EXECUTORS,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 136-157) are reported at 9 T. C. 89.

JURISDICTION

This appeal involves income taxes for the years 1942 and 1943 in the respective amounts of \$1,768.55 and \$67,388.46. (R. 165.) Income tax returns for these years were filed for the taxpayer estate with the Collector of Internal Revenue at San Francisco, California. (R. 137.) On September 20, 1945, the Commissioner of Internal Revenue mailed a notice of deficiency to the taxpayer, advising it of deficiencies in

income tax for 1942 and 1943 in a total amount of \$66,944.62. (R. 4, 10-17.) Within ninety days thereafter, on December 12, 1945 (R. 2), the taxpayer filed a petition with the Tax Court of the United States for a redetermination of the deficiencies under Section 272 of the Internal Revenue Code (R. 4-17). By amended answer (R. 20-22) the Commissioner made claim for increases in the deficiencies previously determined for 1942 and 1943 in the respective amounts of \$596.83 and \$1,652.27 pursuant to Section 274 (e) of the Internal Revenue Code. The decision of the Tax Court, finding deficiencies in income tax for the years 1942 and 1943 in the respective amounts of \$1,768.55 and \$67,388.46, was entered on September 16, 1947. (R. 165.) The case is brought to this Court by a petition for review filed by the taxpayer on October 14, 1947 (R. 3, 166-175), pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether, in determining its taxable net income for 1942 and 1943, the taxpayer estate is entitled, under Section 162 (b), (c), or (d) (1) of the Internal Revenue Code, to deduct, in addition to the income distributed to legatees under the decedent's will, all of the remaining income in each year, although such income was not distributed, was not to be distributed currently, and was not credited, to the legatees in those years.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are printed in the Appendix, *infra*.

STATEMENT

The facts found by the Tax Court (R. 137-145) may be summarized as follows:

On September 2, 1941, the will of Isadore Zellerbach, who died August 7, 1941, was admitted to probate by the Superior Court of California in and for the City and County of San Francisco. Under the will, after bequests of \$5,000 to each of his eight grandchildren, all the rest, residue and remainder of testator's estate was given, devised and bequeathed as follows: An undivided three-sixths thereof to his widow, Jennie B. Zellerbach, and an undivided one-sixth to each of his three children, J. David, Harold L., and Claire. The executors were given full, absolute, and complete power and authority to sell, mortgage, pledge, exchange or otherwise dispose of or deal with the whole or any portion of the estate according to their judgment and discretion and without any court order. The will made no provision for the distribution of the income received by the estate during the period of administration. (R. 137-138.)

On November 25, 1942, the executors filed with the Probate Court a petition for the distribution of \$181,000 from the income of the estate of approximately \$317,000 received during the year 1942 as follows: \$22,000 to the widow and \$53,000 to each of the three children. The petition stated in part that the total value of the estate as shown by the inventory and appraisement was \$4,754,-671.56, and that "it is not proposed at this time to distribute any of the corpus of the residue of the estate, nor any income, save and except that hereinabove described." (R. 138-139.)

After hearing, the Probate Court entered an order dated December 7, 1942, in which it found as follows (R. 139):

* * * that the time for filing claims against said estate has expired; that all claims which have been filed have been allowed, approved and paid; that the federal estate tax, as shown by the return, has been paid; that the State Controller of the State of California has consented in writing to the said distribution; that all personal property taxes due and payable by said estate have been paid; that the distribution prayed for in said petition may be allowed as therein prayed for without injury to said estate or any person interested therein, and that after said distribution sufficient assets will remain in the hands of the executors to pay all debts and expenses of administration; * * *

The order authorized payment "from the income of said estate, for the calendar year 1942, the total sum of \$181,000," payable \$22,000 to the widow and \$53,000 to each of the three children of decedent. (R. 139.)

The distribution of \$181,000 was paid \$180,297.85 out of income and \$702.15 out of corpus. (R. 139.)

On November 25, 1942, the executors filed another petition with the Probate Court praying for authority to distribute from the corpus of the estate certain shares of stock of Crown Zellerbach Corporation and of Rayonier Incorporated, one-half thereof to the widow and one-sixth to each of the three children of decedent. After hearing, the Probate Court entered an order dated December 8, 1942, authorizing

the executors to make distribution of the stock as prayed for. The fair market value of the stock at the time of its distribution was \$1,146,000. (R. 140.)

On December 31, 1942, all the distributions authorized by the Probate Court during the year 1942 had been made. (R. 140.)

An income tax return for the year 1942 was filed for the estate, showing income of \$322,756.33, from which was deducted \$181,000 as the amount distributable to beneficiaries, leaving a net income (taxable to fiduciary) of \$141,756.33, and disclosing a tax liability of \$97,606.47. On December 14, 1943, an amended income tax return was filed for the year 1942 showing income of \$322,756.33, from which was deducted \$315,323.74 as the amount distributable to beneficiaries, leaving a net income (taxable to fiduciary) of \$7,432.59 and disclosing a tax liability of \$1,619.78. (R. 140.)

The total net income of the estate for 1942, before any allowance for income distributed to beneficiaries during the year, was \$324,209.38, which sum is composed of ordinary income in the amount of \$316,595.74 and capital gains in the amount of \$7,613.64. (R. 141.)

On their original income tax returns for 1942 the widow reported \$22,000, and each of the three children reported \$53,000, as distributable income from the estate. On January 24, 1944, the widow filed an amended income tax return in which she reported as having been distributed to her the amount of \$157,661.87, representing one-half of all of the income of the estate for the year 1942. (R. 141.)

Pursuant to a petition of the executors filed June 18, 1943, the Probate Court, on July 7, 1943, entered an order authorizing the executors to make a partial distribution of the assets of the estate, consisting of a parcel of unimproved real property in San Francisco, three-sixths to the widow and one-sixth to each of the three children. The fair market value of the property at the time of distribution was \$27,500. (R. 141.)

Pursuant to a petition of the executors filed August 4, 1943, the Probate Court on August 18, 1943, entered an order authorizing the executors to make a partial distribution of the assets of the estate, consisting of shares of stock of Dreamland Auditorium, Ltd., three-sixths to the widow and one-sixth to each of the three children. The fair market value of the shares at the time of distribution was \$3,450. (R. 141-142.)

On November 30, 1943, the executors filed a petition with the Probate Court for authorization to make a partial distribution consisting of \$96,000, of which \$32,000 was to be distributed to each of the three children of decedent. In the petition it was stated that the income for 1943 would approximate \$191,500; that the executors desired to distribute \$96,000 thereof; and that it was not proposed to distribute any of the corpus of the residue of the estate, nor any income save and except the \$96,000. No portion of the income was requested to be distributed to the widow. On December 13, 1943, the Probate Court entered an order authorizing the income distribution of \$96,000, as prayed for. The distribution

of \$96,000 was paid \$94,164.15 out of income and \$1,835.85 out of corpus. (R. 142.)

The income tax return filed for the estate for 1943 showed income tax income of \$203,895.74 and victory tax income of \$200,811.46, from each of which \$185,328.30 was deducted as the amount distributable to beneficiaries, leaving an income tax net income of \$18,567.44 and a victory tax net income of \$15,483.16. The total income and victory tax liability shown by the return was \$6,712.28. The return contained a schedule allocating \$92,664.15 of the distributable amount of \$185,328.30 to the widow, and \$30,888.05 to each of the three children. (R. 142-143.)

The widow included in her federal income tax return for 1943, as income received by her from the estate, the sum of \$92,664.15. (R. 143.)

The total net income of the estate for 1943, before any allowance for income distributed to beneficiaries during that year, was \$206,864.94, which sum was composed of ordinary income of \$188,328.30 and capital gain of \$18,536.64. (R. 143.)

On petition filed October 26, 1942, the Probate Court, on November 6, 1942, made an order authorizing the executors to borrow a sum not to exceed \$1,000,000, to execute their promissory note or notes payable on or before one year after date with interest at $2\frac{1}{2}$ per cent per annum, and as security therefor to pledge all or any portion of the personal property of the estate remaining in the hands of the executors. Pursuant to such authorization the executors, on November 6, 1942, borrowed from Wells Fargo Bank & Trust Company the sum of \$500,000, pledging as col-

lateral 9,000 shares of the preferred stock of Crown Zellerbach Corporation of the market value at that time of approximately \$720,000. They also borrowed the sum of \$318,669.31 from the widow. On January 15, 1943, a payment of \$100,000 was made, reducing the principal of the bank loan to \$400,000. On August 4, 1943, and on December 6, 1943, additional amounts of \$50,000 and \$75,000 were borrowed, increasing the principal of the loan to \$525,000. The entire loan was paid on March 13, 1944. (R. 143-144.)

The federal estate tax, as disclosed by the return filed, had been paid at December 31, 1943. The Commissioner subsequently determined that the estate was liable for a deficiency in federal estate taxes, which controversy was finally settled in November, 1946. (R. 144.)

On December 31, 1942, the estate had assets of the then value of \$3,425,092.17 and liabilities of \$1,490,565.49, or an excess of assets over liabilities of \$1,934,526.68. This was after the distribution of the amount of \$181,000 and the distribution of corpus of \$1,146,000, and after giving effect to all liabilities which were subsequently determined to be due. (R. 144.)

On December 31, 1943, the assets of the estate had a value of \$3,942,739.89, and the liabilities amounted to \$1,104,886.70, or an excess of assets over liabilities of \$2,837,853.19. (R. 145.)

On these facts the Tax Court held that in determining its taxable net income for 1942 and 1943 the taxpayer estate is entitled to deduct only \$180,297.85 in 1942 and \$94,164.15 in 1943, representing the

amounts of income actually distributed to the residuary legatees in those years. (R. 157.)

SUMMARY OF ARGUMENT

(A) The taxpayer estate is not entitled to deduct its undistributed income for the years 1942 and 1943 under Section 162 (b) of the Internal Revenue Code, because the undistributed income was not currently distributable. The will did not direct distribution of the income currently and under California law the legatees had no present right in 1942 and 1943 to a current distribution of the income, since no orders for distribution were entered in those years. Although the legatees had the right to petition the Probate Court for distribution of the income and, if the statutory procedure for notice and hearing was complied with and if the facts required by the California statutes were made to appear at the hearing, to have orders made in their favor, nevertheless, the entry of orders for distribution was not available as a matter of right but depended on the precedent statutory steps. These steps were not taken in 1942 and 1943. It follows that the undistributed income was not currently distributable in those years.

(B) The undistributed income for 1942 and 1943 may not be deducted by the taxpayer under Section 162 (c) of the Code, because it was not properly credited in those years to the legatees entitled to receive it under the testator's will. There is no evidence that the unpaid income was made unconditionally available to the legatees in 1942 and 1943, and thus there was no credit, as the term is used in the statute.

Nor is the undistributed income to be considered as the income in fact of the legatees on the theory that the period of administration had in fact ended in 1942 and 1943. The estate had large amounts of unpaid liabilities, administration had not been unduly delayed, and the estate was still in process of administration under California law.

(C) The distributions of corpus made in the years 1942 and 1943 are not, under Section 162 (d) (1) of the Code, to be treated as distributions of income to the extent of the undistributed income, and thus deductible under Section 162 (c). Section 162 (d) (1) in terms applies only to gifts, bequests, and inheritances which are to be paid, credited, or distributed at intervals. The bequest of the residuary estate in this case was not, under the will, payable at intervals, but was a lump sum legacy of the entire residue, and thus outside the scope of Section 162 (d) (1). The mere fact that partial distributions were made upon court order from time to time does not convert the bequest into one which was to be paid, credited, or distributed at intervals.

ARGUMENT

The taxpayer is entitled to deduct only the income distributed by it in 1942 and 1943

The net income of an estate during the period of administration or settlement is liable for the same income taxes as are imposed on individuals and the taxes are to be paid by the fiduciary under Section 161 of the Internal Revenue Code (Appendix, *infra*). The net income of the estate is computed on the same basis

as the net income of an individual, except that, as provided in Section 162 of the Internal Revenue Code, certain additional deductions are allowed to the estate.

The only question in this case is whether the taxpayer estate is entitled under Section 162 (b), (c), or (d) (1) of the Code (Appendix, *infra*) to deduct in 1942 and 1943, for purposes of determining its taxable net income, its entire income for each year, as it contends, or whether, as the Tax Court held, the taxpayer is permitted by these subsections to deduct only the amounts of income actually distributed to the residuary legatees in 1942 and 1943. The following discussion will show that the Tax Court correctly held that Section 162 (b), (c), and (d) (1) does not authorize deduction by the taxpayer of any income in excess of the amounts distributed in the taxable years.

At the outset it is observed that the general purpose underlying Section 162 is to tax, either to the fiduciary, the beneficiaries, or partly to each, all of the net income of estates or trusts for each year. If none of the net income is paid, credited, or is currently distributable to the beneficiaries, the net income without further deduction is taxable to the fiduciary. But he is allowed credit for any amount, paid, credited, or currently distributable, to a beneficiary within that year, and this amount then becomes taxable income of the beneficiary. *Helvering v. Butterworth*, 290 U. S. 365; *Freuler v. Helvering*, 291 U. S. 35, 41-42.

A. Section 162 (b)

Under Section 162 (b) the income of the estate for its taxable year "which is to be distributed currently

by the fiduciary to the legatees'' may be deducted, but the amount allowed as a deduction must be included in the income of the ~~beneficiaries~~ ^{legatees} for that year, whether distributed to them or not. The term ''income which is to be distributed currently'' includes income for the taxable year of the estate which ''becomes payable'' to the legatees within the year.¹ Thus, the estate may deduct, under this subsection, all of its income in 1942 and 1943, as it contends, only if the income was to be distributed currently or become payable within those years.

The testator's will itself contained no provision directing that the income received by the estate during the period of administration was to be distributed currently to the legatees named by him. (R. 138.) On the contrary, the will implies that distribution of the income was to be discretionary with the executors, since they were given complete power to deal with the estate or any part according to their judgment and discretion and without court order. (R. 138.) Consequently, the legatees had no present enforceable right to receive the income in 1942 and 1943 under

¹ This provision was added by Section 111 (b) of the Revenue Act of 1942 to the existing statute and was explained in S. Rep. No. 1631, 77th Cong., 2d Sess., p. 71-72 (1942-2 Cum. Bull. 504, 559-560), as follows:

'' Your committee bill adds an amendment to section 162 (b) of the Code designed to include in the income of a legatee or beneficiary the income of the estate or trust for its taxable year which, within such taxable year, becomes payable to the legatee or beneficiary, even though it then becomes payable as part of an accumulation of income held until the happening of some event which occurs within the taxable year. Such cases are usually cases where accumulated income of an estate is paid to a residuary legatee upon termination of the estate or where income of a trust

the terms of the will, and to bring the case within Section 162 (b), it must appear that they had a *recognized present right* in those years under the local law to obtain the income or compel its distribution. See Section 29.162-2 (b) of Treasury Regulations 111 (Appendix, *infra*). Cf. *Freuler v. Helvering*, 291 U. S. 35, 42. As was stated in *Plimpton v. Commissioner*, 135 F. 2d 482, 485-486 (C. C. A. 1st):

* * * The scheme of the statute is to allow deductions to a fiduciary as to income which he is under *an absolute obligation to pay* to a beneficiary, whether he has in fact done so or not, and to tax such income to the beneficiary; but, by a similar technique of deduction, not to tax income to a beneficiary *which he is not entitled to receive as of right* until such income has been actually *received*. * * * [Italics supplied].

See also *Commissioner v. Stearns*, 65 F. 2d 371, 373 (C. C. A. 2d), certiorari denied, 290 U. S. 670; *Commissioner v. First Trust & D. Co.*, 118 F. 2d 449, 452 (C. C. A. 2d).

is accumulated for distribution upon the beneficiary's reaching a specified age.

(^c The question of whether the income of an estate or trust for the taxable year in which it becomes payable as part of an accumulation is taxable on the one hand to the estate or trust or on the other hand to the legatee or beneficiary has been a source of litigation in certain cases under existing law. This amendment is designed to clarify the law. * * *)

The provision was discussed and construed in *Carlisle v. Commissioner*, 165 F. 2d 645 (C. C. A. 6th). Cf. *Anderson's Estate v. Commissioner*, 126 F. 2d 46 (C. C. A. 9th), certiorari denied, 317 U. S. 653, and *Commissioner v. Bishop Trust Co.*, 136 F. 2d 390 (C. C. A. 9th).

The Tax Court held here that under California law, the legatees had no present right in 1942 and 1943 to the income of those years, but merely a potential right which, as to the amounts not distributed, was neither recognized nor enforced in those years. (R. 152.) This holding is plainly correct.

While under Section 300 of the California Probate Code (Appendix, *infra*) title to a decedent's property passes at death to his devisees and legatees, under the express terms of the section, all the property remains in the possession of the executor, under the control of the superior court for purposes of administration, and is subject to payment of the decedent's debts and expenses of administration. See *Murphy v. Farmers' etc. Bank*, 131 Cal. 115, 119, and *Dabney v. Dabney*, 54 Cal. App. 2d 695, 699. The executor is under control of the court in handling the property and derives his authority to act from orders of the court. *Estate of Palm*, 68 Cal. App. 2d 204, 212. A decree of distribution serves to release the property from the administration to which it was subject and to transfer possession of the property to the legatees. *Bates v. Howard*, 105 Cal. 173, 183. Cf. also Section 1021 of the Probate Code (Appendix, *infra*), which permits the persons named in a decree of final distribution to recover their respective shares from the executor on the basis of the order which is conclusive when final.

The mere fact that legal title to what will be the residuary estate after administration is concluded vested in the legatees in this case is not determinative,

contrary to taxpayer's argument² (Br. 29-35), where their title is contingent upon an order of distribution. See *Dunlop v. Commissioner*, 165 F. 2d 284, 287 (C. C. A. 8th). The question under Section 162 (b) is whether or not the legatees were entitled as a matter of right to take possession of the income in the years in which it was received, because it was to be distributed currently to them. As already shown, Section 300 denies this right to them until the superior court has ordered distribution. Cf. also Section 1021 of the Probate Code. It remains to consider the procedure for distribution.

Section 1000 of the California Probate Code (Appendix, *infra*) authorizes the executor or the legatee (at any time after the lapse of four months from the issuance of letters testamentary) to petition the court for a distribution of any part of the estate. Upon filing, the petition must be set for hearing by the court and notice of the petition must be given as provided in Section 1200 of the Probate Code (Appendix, *infra*), that is, by posting the notice at the courthouse at least ten days before the day of hearing and by mailing notice to the executors or administrator (when they are not the petitioners), and to all persons who have requested notice or who have given notice of appearance in the estate. The jurisdiction of the court

² G. C. M. 22034, 1940-1 Cum. Bull. 90, quoted by taxpayer in this connection (Br. 30-32), involved a set of facts in which all of the income for the year was actually distributed during the year pursuant to court order. The income was held to be "properly paid" to the beneficiaries within Section 162 (c). The ruling is inapplicable in the present case, which involves only the status of *undistributed* income.

to hear the petition and to order distribution depends on the giving of notice as prescribed by statute. *Estate of Dam*, 126 Cal. App. 70, 73–76; *Lilienkamp v. Superior Court*, 14 Cal. 2d 293, 298, 301. Any interested person is entitled under Section 1000 to appear and resist the application for distribution. *Dabney v. Dabney*, *supra*, p. 701. Section 1001 (Appendix, *infra*) provides, that if, *at the hearing*, it appears that the estate is “but little indebted,” that all inheritance taxes have been paid or that the designated state official has consented in writing to the distribution, and that the part of the estate sought in the petition to be distributed may be distributed without loss to the creditors, or injury to the estate or any interested person, then the court “shall make an order” of distribution, subject to such bond as the court may designate.³

These statutes require the determination of issues of fact (*Estate of Hill*, 94 Cal. App. 113, 115), the statutory facts must be established by the court’s findings (cf. *Estate of Dutard*, 147 Cal. 253, 255) and only if the prescribed conditions have been shown to exist, is an order for partial distribution mandatory (*Estate of Stephenson*, 65 Cal. App. 2d 120, 123). As the probate judge in charge of the taxpayer estate testified in this case (R. 122), the granting of a peti-

³ Cf. Sections 1010 and 1011 of the California Probate Code (Appendix, *infra*) authorizing the filing of a petition for a ratable distribution, after the time for filing claims has expired and all uncontested claims have been paid or secured but the estate cannot be closed finally, and directing, after similar notice, hearing, and the finding of the same facts as are required by Section 1001, the entry of an order for a ratable distribution.

tion for partial distribution entails the exercise of judgment and discretion, and it was so held in *In re Painter*, 115 Cal. 635, 640.

Under the California statutes, therefore, the residuary legatees in this case were not entitled to an order for the current distribution of the income of the estate to them as a matter of right. They had a right to petition for a distribution in 1942 and 1943, but until a petition was filed, notice was given, a hearing was held, and the facts set out in the statute were proved at the hearing, the legatees had no present right whatever to an order of distribution. None of the things fixed by the statutes as prerequisite conditions to the court's jurisdiction or obligation to enter orders of distribution were done in this case as to the income in excess of \$181,000 in 1942 and \$96,000 in 1943. Because, as previously shown, the right to distribution depended upon an order for distribution by the court, and because no orders were made or were obtainable as a matter of right, it necessarily follows that the undistributed income in 1942 and 1943 was not currently distributable in those years by virtue of California law within the meaning of Section 162 (b). See *Estate of Cohen v. Commissioner*, 8 T. C. 784, 786; *Estate of Igoe v. Commissioner*, 6 T. C. 639, 645-646. See also *Commissioner v. First Trust & D. Co.*, 118 F. 2d 449, 452 (C. C. A. 2d), where the court pointed out that income was not currently distributable within the meaning of Section 162 (b), since the instrument did not impose a duty on the fiduciary to make periodic distributions of current income and since the beneficiaries under state law could compel the

distribution of income or principal to them *only after an accounting* by the fiduciary *and decree* rendered thereon.

Administrative considerations lend weight to the view that Congress intended to establish as the test of whether or not income was to be distributed currently within the meaning of Section 162 (b) the absolute right under state law to a distribution, rather than the mere right to petition for an order of distribution, and to have such order if the necessary facts should be established to the satisfaction of the court. If the latter were the test, the Commissioner in order to determine whether Section 162 (b) applied, would in each case be required to inquire into the financial condition of the estate and to decide whether a Probate Court would have granted a petition for distribution if it had been filed, if notice had been given, if a hearing had been held, and if the interested persons had or had not objected to the petition. Nothing in the language used by Congress warrants the imposition of this heavy administrative burden. Cf. *Plimpton v. Commissioner*, 135 F. 2d 482, 486 (C. C. A. 1st).

The circumstance that petitions for distribution of the income in question would probably have been granted by the probate judge in the exercise of his discretion (cf. R. 119-123) if they had been made, if notice had been given, if a hearing had been held, and if the statutory facts had been shown at the hearing, is not controlling. The preliminary steps required by the statute before distribution could be ordered were not taken and the income would not become distribut-

able under California law until they were taken and an order was entered. The possibility that the income could have been made currently distributable in 1942 and 1943, if the proper steps had been taken, does not suffice to show that the income was currently distributable. Cf. *Plimpton v. Commissioner, supra*, in which the court held that income was not currently distributable within the statutory sense under an instrument permitting distribution in the discretion of the trustees even though as a practical matter the income was distributable currently to the beneficiary who was also a trustee, since the other trustees were completely amenable to the will of the beneficiary-trustee as to distribution of the income.

The taxpayer argues (Br. 20-22) that, because the Probate Court made findings in the decrees of distribution made in 1942 and 1943, which covered all the necessary points under Sections 1000 and 1001 of the Probate Code, the court no longer had any discretion to exercise and orders for distribution of all the income in both years would have been mandatory. But this contention overlooks the fact that Section 1001 requires that the facts necessary to support an order of distribution *shall appear at the hearing* on the petition as to which the order is made. Furthermore, even if the statutory facts could be taken as already settled by findings made on other petitions, the court had no jurisdiction to make orders of distribution of the remaining income in 1942 and 1943 because no petitions for distribution were filed, no notices of hearing were given, no opportunity was

given to interested persons to object, and no hearings were held, all of which were required by the statutes.

The argument (Br. 22-24) that the widow had a "present right" to distribution of the remaining income in 1942 and 1943 because the three children received their share of the income in those years has no merit. The right of the widow to a distribution at some time of a share of the income for those years in the proportion given her by the testator is not disputed, but the question is whether her share was presently distributable in 1942 and 1943. Since her right to current distribution depended on entry of orders of distribution in her favor, which were not entered, it is irrelevant that orders had been entered authorizing distribution of other amounts to other legatees.⁴

B. Section 162 (c)

Section 162 (c) of the Code authorizes an estate during the period of administration to deduct the income of the estate for its taxable year which is properly paid or credited during the year to any legatee, provided the amount allowed as a deduction is included in the legatee's income.⁵

⁴ In view of the express provisions in Section 162 (b) of the Code and Section 29.162-2 (b) of Treasury Regulations 111, the Government has never contended, nor did the Tax Court hold, that actual distribution of the widow's share of the income to her was necessary for Section 162 (b) to apply. Thus, the taxpayer's "third point" (Br. 24-28) seems to have no relevance, the fact that actual distribution is not required by Section 162 (b) being admitted.

⁵ Section 162 (c) also applies to income which in the discretion of the fiduciary may either be distributed to the beneficiary or accumulated, but this has no relevance here since the will was silent

The taxpayer estate has been allowed deductions by the Tax Court for the income paid to the legatees in 1942 and 1943 pursuant to the orders of distribution so that the only question here is whether it properly "credited" in 1942 and 1943 any of the unpaid and undistributed income for those years to the legatee entitled to receive it under the will. The Tax Court held (R. 152) that there was no evidence that the undistributed income of these years was "properly credited" to any of the beneficiaries as required by statute.

The taxpayer apparently contends in this Court that the undistributed income was "credited" to the widow because the other legatees, the three children, received their proportionate shares of the income in 1942 and 1943. (Br. 22-24, 27-29). But the mere fact that the widow would have been entitled to receive the remaining income in 1942 and 1943 if she had petitioned the Probate Court and procured an order for its distribution does not establish that the income was credited to her in those years. Income is credited within the meaning of Section 162 (c) when it is allocated to, or set aside for, the beneficiaries in such a way as to be unconditionally available to them. See *Frank's Trust of 1931 v. Commissioner*, 165 F. 2d 992 (C. C. A. 3d); *Commissioner v. Stearns*, 65 F. 2d 371, 373 (C. C. A. 2d), certiorari denied, 290 U. S. 670; *Lynchburg Trust & S. Bank v. Commissioner*, 68 F. 2d 356, 359 (C. C. A. 4th), certiorari denied, 292 U. S. 640.

as to distribution or accumulation of the income accruing to the estate during administration.

Estate of Igoe v. Commissioner, 6 T. C. 639, on which taxpayer relies here, involved entirely different facts, as the Tax Court pointed out. (R. 152-153.) There specific credits were made to the accounts of the beneficiaries from which they drew large amounts of cash, and the facts warranted the finding that the credits were unconditionally available to the beneficiaries at all times (p. 647) and thus that the amounts were properly credited within Section 162 (c). Nothing done in the present case is comparable to the facts showing credits in the *Igoe* case.

The question of whether a proper credit has been made is one primarily for the Tax Court (*Frank's Trust of 1931 v. Commissioner, supra*, p. 993), and here the record fully supports its conclusion that the undistributed income was not properly credited to the legatees in 1942 and 1943. It follows that the amount of the undistributed income may not be deducted by the taxpayer under Section 162 (c).

The taxpayer also argues briefly (Br. 44-46) that the Commissioner could have determined that the period of administration referred to in Section 162 (c) of the Code had ended within the meaning of Section 29.162-1 (c) of Treasury Regulations 111 (Appendix, *infra*), thus that the residue would be deemed to have been distributed, and that all the income would be in fact the income of the residuary legatees. The Commissioner, however, *did not determine* that the period of administration had ended, and the regulation cited above does not require it, since there was no showing here that the ordinary duties of administration had been performed. As the Tax Court pointed out (R.

151), the administration had been in progress for only two years, the estate had unpaid liabilities still outstanding at the end of 1943 in excess of \$1,100,000, and the estate tax liability had not at that time been finally determined. The existence of such a large amount of unpaid debts clearly forbids the conclusion that administration had actually been completed, particularly where the period of administration had not been unreasonably delayed and had not been terminated under local law. Cf. *Chick v. Commissioner* (C. C. A. 1st), decided February 27, 1948 (1948 P-H, par. 72,384); *Frederick v. Commissioner*, 145 F. 2d 796 (C. C. A. 5th).

C. Section 162 (d) (1)

The taxpayer argues (Br. 35-44) that the distributions of corpus ordered by the Probate Court in the years 1942 and 1943 should, under Section 162 (d) (1) of the Code, be deemed to be distributions of income in the amounts of the fair market values of the corpus distributed,⁶ and deductible as payments of income

⁶ The taxpayer of course could not contend that the distributions of the stocks and real estate authorized to be distributed in kind were in fact distributions of income. The petition of the executors filed November 25, 1942, prayed for authority to distribute from corpus certain shares of stock (R. 140) and the two petitions on June 18, 1943, and August 4, 1943, requested authority to make a partial distribution of the assets of the estate (R. 141-142). This is in contrast to the petitions in 1942 and 1943 which requested authority to distribute specific amounts from the *income* of the estate for each year, and the orders entered on the petitions which authorized distributions of *income*. (R. 138-139, 142). Thus, both the taxpayer's executors and the Probate Court clearly identified the distributions which were of income and those which were from corpus.

under Section 162 (c). The Tax Court properly rejected this contention. (R. 153-157.)

Section 162 (d)(1) was added to the Code by Section 111 (c) of the Revenue Act of 1942 and, by an express exception, it has no application to gifts or bequests which are not directed to be paid, credited, or distributed at intervals. In cases where the will or trust instrument directs an amount to be paid, credited, or distributed *at intervals* (e. g., an annuity), and under the terms of the will or instrument the amount may be taken from "other than income" of the estate or trust (e. g., an annuity payable out of income but if that is insufficient, out of corpus), the section provides that the amount paid, credited, or to be distributed currently during the taxable year shall be considered as made from income, to the extent of the distributable income of the estate or trust for the year. The section was explained in S. Rep. No. 1631, 77th Cong., 2d Sess., p. 72 (1942-2 Cum. Bull. 504, 560), as follows:

Section 162 of the Code is proposed to be amended by the addition of a new subsection (d), which contains three paragraphs. Paragraph (1) is similar to section 162 (d) as proposed to be added by section 110 of the bill passed by the House, but provides more detailed rules for allocating income among legatees and beneficiaries in cases in which amounts can be paid, credited, or distributed out of other than income.

Section 162 (d) (1) applies to all cases in which the executor or trustee can or must (by the terms of the trust instrument or will) pay

the whole or any part of a gift, bequest, devise, or inheritance out of other than income, except that no income is to be allocated under it to a legatee, heir, or beneficiary of a lump sum gift, bequest, devise, or inheritance. It applies in all cases of annuities where any deficiency in the amount to be paid can be made up by a payment out of corpus of the trust. It also applies in cases where amounts are to be paid or credited at intervals and the executor or trustee has discretion whether to pay or credit such amounts out of income or corpus, regardless of the source (income or corpus) to which the executor attributes such amount. * * *

As the Tax Court pointed out (R. 155-156) the subsection was enacted as a complement to the amendment to Section 22 (b) (3) of the Internal Revenue Code made by Section 111 (a) of the Revenue Act of 1942 (26 U. S. C. 1940 ed., Sec. 22). *Burnet v. Whitehouse*, 283 U. S. 148, and *Helvering v. Pardee*, 290 U. S. 365, had previously stated the rules that recurrent amounts received under a gift, bequest, or by inheritance as an annuity, where the amounts were to be paid at all events whether or not from income or corpus, were not taxable income of the beneficiary under Section 22 (b) (3), and were not deductible by the fiduciary under Section 162 to the extent of the income distributed in payment of such annuity. The basic purpose of the 1942 amendments to Sections 22 (b) (3) and 162 was to counteract the effect of these decisions. S. Rep. No. 1631, *supra*, p. 70; H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 66-68 (1942-2

Cum. Bull. 372, 424-425). See also *Carlisle v. Commissioner*, 165 F. 2d 645 (C. C. A. 6th).

The instant case is not within Section 162 (d) (1), as the Tax Court held (R. 154-155), because the will here did not make a bequest of an annuity, or of amounts to be paid, credited, or distributed at intervals. The testator merely bequeathed his residuary estate to his wife and children, a lump sum bequest, and this type of bequest is specifically excluded from the operation of Section 162 (d), as already noted. Section 29.162-2(a) of Treasury Regulations 111 (Appendix, *infra*) so construes the statute and the legislative history, referred to above, shows that a legacy of this type, having no similarity to an annuity, was not within the scope of the amendments. The mere fact that partial distributions were authorized from time to time and that distribution was not ordered to be made all at one time does not convert the bequest into one which, under the terms of the will, was to be distributed at intervals, or as an annuity.

Nor do Sections 1000 and 1010 of the California Probate Code make the bequest one which was payable at intervals, as taxpayer contends. (Br. 42.) These sections do not purport to change the character of the bequest and do not direct that a lump sum bequest *must* be distributed periodically or at intervals. They merely permit the filing of a petition for distribution of a legacy, or a part thereof, in certain circumstances.

Taxpayer cites G. C. M. 24702, 1945 Cum. Bull. 241 (Br. 38-40), as supporting its contention. A reading of the memorandum shows that it does not. It was not concerned with Section 162 (d) (1) in any way.

It ruled that an amount distributed by an estate out of its income during the year in which the residue became payable was taxable income of the residuary legatee and deductible by the estate under Section 162 (b) of the Code, as amended by Section 111 (b) of the Revenue Act of 1942. This conclusion was based on the 1942 amendment and its legislative history (see fn. 1, *supra*), which was intended to contravene previous cases which had treated such distributions as exempt from tax as corpus on the theory that when administration was completed, the residue was determined, that the residue included the undistributed income earned during administration, and that the residue consisting of both principal and income was received by the legatee as a bequest, exempt from income tax under Section 22 (b) (3), (prior to the 1942 amendment). E. g., *Anderson's Estate v. Commissioner*, 126 F. 2d 46 (C. C. A. 9th).

The ruling has no application to the problem in the present case, which does not involve income distributed in the year in which administration ends and the residue becomes fixed, and further, in any case, as already stated, the ruling does not construe or apply Section 162 (d) (1).

Finally, the regulations support the Tax Court's holding that the case at bar is not covered by Section 162 (d) (1). See Section 29.162-2 (a), quoted in the Appendix, *infra*. The portion of the regulation printed by taxpayer (Br. 41-42) deals merely with the method of allocating income *in cases to which Section 162 (d) (1) applies*, and it has no bearing in a case like the present where the section does not apply.

CONCLUSION

The decision of the Tax Court should be affirmed.
Respectfully submitted.

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APRIL 1948.

APPENDIX

California Probate Code (Deering's California Codes, Annotated, 1944):

§ 300. *Title to decedent's estate: [When property passes: Possession and control thereof: Liability for administration expenses, debts and family allowance]*. When a person dies, the title to his property, real and personal, passes to the person to whom it is devised or bequeathed by his last will, or, in the absence of such disposition, to the persons who succeed to his estate as provided in Division II of this code; but all of his property shall be subject to the possession of the executor or administrator and to the control of the superior court for the purposes of administration, sale or other disposition under the provisions of Division III of this code, and shall be chargeable with the expenses of administering his estate, and the payment of his debts and the allowance to the family, except as otherwise provided in this code.

§ 956. *Closing administration: [Payment of legacies: Distribution: Debts unpaid: Condition of estate]*. If all of the debts have been paid by the first order for payment, the court must direct the payment of legacies and the distribution of the estate among the persons entitled, as provided in the next chapter; but if there are debts remaining unpaid, or if, for other reasons, the estate is not in a condition to be closed, the administration may continue for such time as may be reasonable.

§ 1000. *Petition [by person entitled: Hearing: Notice: Persons entitled to oppose]*. At any time after the lapse of four months from the issuing of letters testamentary or of administra-

tion, the executor or administrator, or any heir, devisee or legatee, or the assignee, grantee or successor in interest of any heir, devisee or legatee, may petition the court to distribute a legacy, devise or share of the estate, or any portion thereof, to any person entitled thereto, upon such person giving a bond as hereinafter provided. The clerk shall set the petition for hearing by the court and give notice thereof for the period and in the manner required by section 1200 of this code. When the petitioner is not the executor or administrator, notice must be given to the executor or administrator by citation. An executor or administrator, not petitioning, or any person interested in the estate may resist the application.

§ 1001. *Allowance of distributee's share: [Facts shown at hearing: Indebtedness to estate: Taxes: Possibility of loss or injury: Order for delivery: Bond of recipient]*. If, at the hearing, it appears that the estate is but little indebted and that all inheritance taxes payable in said proceeding have been paid, or that the State Controller, an inheritance tax attorney, or an assistant inheritance tax attorney has in writing consented to said distribution and the legacy, devise or share of the estate, or any portion thereof, may be distributed to the person entitled thereto, without loss to the creditors or injury to the estate or any person interested therein; the court shall make an order requiring the executor or administrator to deliver the legacy, devise or share of the estate or such portion thereof as the court may designate, to the person entitled thereto, upon receiving from such person a bond executed by him, and payable to the executor or administrator in such sum as the court may designate, with sureties to be approved by the judge, and conditioned for the payment, whenever required, of the proportion of the debts due from the estate, not exceeding the value or amount of the legacy or

portion of the estate, so ordered to be delivered. When the time for filing or presenting claims has expired, and all uncontested claims have been paid or are sufficiently secured by mortgage or otherwise, and the court is satisfied that no injury can result to the estate, the court may dispense with the bond.

§ 1010. *Petition: [Setting for hearing: Notice: Persons entitled to oppose]*. When the time for filing or presenting claims has expired and all uncontested claims have been paid, or are sufficiently secured by mortgage, or otherwise, but the estate is not in a condition to be finally closed and distributed, the executor or administrator, or any heir, devisee or legatee, or the assignee, grantee or successor in interest of any heir, devisee or legatee, may petition the court for a ratable payment of the legacies, or ratable distribution of the estate, to the heirs, devisees or legatees, or their assignees, grantees or successors in interest, or, where there are priorities, to those of the class or classes having priority; or, if the decedent was a nonresident and left a will which has been duly proved or allowed in the State of his residence, and it is necessary, in order that the estate or any part thereof may be distributed according to the will, or it is for the best interests of the estate, that any part of the estate in this State should be delivered to the executor or administrator in the State of the decedent's residence, the executor or administrator may petition the court for an order authorizing the delivery of such portion of the estate as the court shall deem safe and proper and for the best interests of the estate, to the executor or administrator in the State of the decedent's residence. The clerk shall set the petition for hearing by the court and give notice thereof for the period and in the manner required by section 1200 of this code. Any person interested in the estate or

any coexecutor or coadministrator may resist the application.

§ 1011. [*Hearing: Showing of essential facts: Order requiring distribution*]. If, at the hearing, it appears that the allegations of the petition are true, that all inheritance taxes payable in said proceeding have been paid or that the State Controller, an inheritance tax attorney, or an assistant inheritance tax attorney, has in writing consented to said distribution, and that no injury will result to the estate or any person interested therein, the court shall make an order requiring the executor or administrator to deliver to the heirs, devisees or legatees, or to their assignees, grantees or successors in interest, or to the executor or administrator in the State of decedent's residence, such portion of the estate as the court may designate.

§ 1021. *Decree of distribution: [Naming of persons and shares: Right to recover shares: Conclusiveness of decree]*. In its decree, the court must name the persons and the proportions or parts to which each is entitled, and such persons may demand, sue for, and recover their respective shares from the executor or administrator, or any person having the same in possession. Such order or decree, when it becomes final, is conclusive as to the rights of heirs, devisees and legatees.

* * * * *

§ 1200. *Mode of giving notice in certain instances: [Posting of notice: Notice by mail: Proof of notice: Effect of finding.]* Upon the filing * * * of a petition for partial or ratable or final distribution, * * * and in all cases in which notice is required and no other time or method is prescribed by law or by court or judge, the clerk shall set the same for hearing by the court and shall give notice of the petition or application or report or account by causing a notice to be posted at the courthouse of the county where the proceedings

are pending, at least ten days before the day of hearing, giving the name of the estate, the name of the petitioner and the nature of the application, referring to the petition for further particulars, and notifying all persons interested to appear at the time and place mentioned in the notice and show cause, if any they have, why the order should not be made.

Notice by mail. At least ten days before the time set for the hearing of such petition, account or report, the petitioner or person filing the account or desiring the confirmation of a report of appraisers must cause notice thereof to be mailed to the executor or administrator, when he is not the petitioner, to any coexecutor or coadministrator not petitioning, and to all persons (or to their attorneys, if they have appeared by attorney), who have requested notice or who have given notice of appearance in the estate in person or by attorney, as heir, devisee, legatee or creditor, or as otherwise interested, addressed to them at their respective post-office addresses given in their requests for special notice, if any, otherwise at their respective offices or places of residence, if known, and if not, at the county seat of the county where the proceedings are pending, or to be personally served upon such persons.

[*Proof of notice: Effect of finding.*] Proof of the giving of notice must be made at the hearing; and if it appears to the satisfaction of the court that said notice has been regularly given, the court shall so find in its order, and such order, when it becomes final, shall be conclusive upon all persons.

Internal Revenue Code:

SEC. 161. IMPOSITION OF TAX.

(a) *Application of Tax.*—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) *Computation and Payment.*—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor).

* * * * *

(26 U. S. C. 1940 ed., Sec. 161)

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

* * * * *

(b) [as amended by Section 111 (b), Revenue Act of 1942, c. 619, 56 Stat. 798]: There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the legatees, heirs, or beneficiaries, but the amount so allowed as a deduction shall be included in computing the net income of the legatees, heirs, or beneficiaries

whether distributed to them or not. As used in this subsection, 'income which is to be distributed currently' includes income for the taxable year of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary;

(d) [as added by Section 111 (c), Revenue Act of 1942, c. 619, 56 Stat. 798] *Rules for Application of Subsections (b) and (c).*—For the purposes of subsections (b) and (c)—

(1) *Amounts Distributable Out of Income or Corpus.*—In cases where the amount paid, credited, or to be distributed can be paid, credited, or distributed out of other than income, the amount paid, credited, or to be distributed (except under a gift, bequest, devise, or inheritance not to be paid, credited, or distributed at intervals) during the taxable year of the estate or trust shall be considered as income of the estate or trust which is paid, credited, or to be distributed if the aggregate of such amounts so paid, credited, or to be distributed does not exceed the distributable income of the estate or trust for its taxable year. If the aggregate of

such amounts so paid, credited, or to be distributed during the taxable year of the estate or trust in such cases exceeds the distributable income of the estate or trust for its taxable year, the amount so paid, credited, or to be distributed to any legatee, heir, or beneficiary shall be considered income of the estate or trust for its taxable year which is paid, credited, or to be distributed in an amount which bears the same ratio to the amount of such distributable income as the amount so paid, credited, or to be distributed to the legatee, heir, or beneficiary bears to the aggregate of such amounts so paid, credited, or to be distributed to legatees, heirs, and beneficiaries for the taxable year of the estate or trust. For the purposes of this paragraph "distributable income" means either (A) the net income of the estate or trust computed with the deductions allowed under subsections (b) and (c) in cases to which this paragraph does not apply, or (B) the income of the estate or trust minus the deductions provided in subsections (b) and (c) in cases to which this paragraph does not apply, whichever is the greater. In computing such distributable income the deductions under subsections (b) and (c) shall be determined without the application of paragraph (2).

* * * * *

(26 U. S. C. 1940 ed., Sec. 162.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.162-1. INCOME OF ESTATES AND TRUSTS.—

* * * * *

From the gross income of the estate or trust there are also deductible (either in lieu of, or in addition to, the deductions referred to in the preceding paragraph of this section) the following:

* * * * *

(b) Any income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to a legatee, heir, or beneficiary, whether or not such income is actually distributed. For this purpose, it is provided in section 162 (b) that "income which is to be distributed currently" includes income of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary.

(c) Any income of the estate of a deceased person for its taxable year which is properly paid or credited during such year to a legatee or heir, and any income either of such an estate or of a trust for its taxable year which is similarly paid or credited during that year to a legatee, heir, or beneficiary if there was vested in the fiduciary a discretion either to distribute or to accumulate such income.

* * * *

The income of an estate of a deceased person, as dealt with in the Internal Revenue Code, is therein described as received by the estate during the period of administration or settlement thereof. The period of administration or settlement of the estate is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. * * *

* * * *

SEC. 29.162-2. ALLOCATION OF ESTATE AND TRUST INCOME TO LEGATEES AND BENEFICIARIES.—

(a) *Allocation among annuitants.*—Section 162 (d) (1) applies to all cases in which the executor or trustee can or must (for example, by the terms of the trust instrument or will) pay the whole or any part of a gift, bequest,

devise, or inheritance out of other than income, except that no income is to be allocated under it to a legatee, heir, or beneficiary of a lump sum gift, bequest, devise, or inheritance. It applies in all cases of annuities where any deficiency in the amount to be paid can be made up by a payment out of corpus of the trust. It also applies in cases where amounts are to be paid or credited at intervals and the executor or trustee has discretion whether to pay or credit such amounts out of income or corpus, regardless of the source (income or corpus) to which the executor or trustee attributes such amount. * * *

* * * * *

(b) *Allocation among income beneficiaries and legatees.*—* * * As used in section 162, the term “income which becomes payable” means income to which the legatee, heir, or beneficiary has a present right, whether or not such income is actually paid. Such right may be derived from the directions in the trust instrument or will to make distributions of income at a certain date, or from the exercise of the fiduciary’s discretion to distribute income, or from a recognized present right under the local law to obtain income or compel a distribution of income. Income is not considered to become payable within a taxable year where during the entire taxable year there is only a future right to such income. For example, under valid terms of a trust instrument, income received by a trust during its taxable year is to be accumulated until the twenty-first birthday of the beneficiary (or his prior death), at which time the accumulated income is to be distributed to the beneficiary (or his estate, as the case may be). In such case, the income of the trust received in any taxable year prior to the taxable year of the trust in which the date of distribution occurs (the beneficiary’s twenty-first birthday or his prior death) is not income which becomes payable

within such prior taxable year but is income which becomes payable in the taxable year of the trust in which the date of distribution occurs. In any case, income becomes payable at a date not later than the date it is actually paid for the use of the distributee.

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